

January 7, 2002

Mary L. Cottrell, Secretary  
Department of Telecommunications and Energy  
One South Station, Second Floor  
Boston, Massachusetts 02110

**RE: D.T.E. 01-100 (Risk-Management NOI)**

Dear Secretary Cottrell:

This correspondence is a response to the Request For Comments initiated by the D.T.E. to investigate the appropriateness of the use of Risk-Management Techniques to Mitigate Natural Gas Price Volatility.

Following is an Executive Summary and comments on the nine questions. I will be happy to provide any more information that is necessary to assist the Department in its efforts in this matter of Docket # D.T.E. 01-100.

Sincerely Yours,

Bill Bagnell

William R. Bagnell  
Senior Vice President  
Planalytics, Inc.  
1325 Morris Drive, Suite 201  
Wayne, PA 19087  
(610) 407-2938  
[wbagnell@planalytics.com](mailto:wbagnell@planalytics.com)

Enclosures  
cc: Service List  
cc: Paul M. Corby, SVP, Planalytics

## **EXECUTIVE SUMMARY**

Natural gas price volatility is a part of all of our lives, and will continue to be for the foreseeable future. There is great risk inherent in wildly fluctuating prices and unless a utility is able to effectively manage that risk, then both ratepayers and shareholders will suffer.

Risk-Management techniques have been used in the financial industry for decades. These techniques are becoming more common in the energy industry and as a result of the volatile natural gas prices of 2000/2001, they are becoming mandatory in order to give consumers the confidence that is necessary that their utility is doing everything it can to protect their interests.

The most important aspect of a risk management program, from our perspective, is that a natural gas portfolio be diversified with several types of purchasing practices all designed to reduce price volatility and at the same time derive the best price. Any form of speculation, on the contrary, should be avoided as it exposes the ratepayer to inordinate risks and the possibility of paying excessive amounts for their natural gas.

It is our contention that prudently-incurred costs of risk management programs should be recoverable by the utilities as these programs are designed with the ultimate goal of protecting the ratepayer. Without these programs in place, customers will surely face a repeat of the high prices of the 2000/2001 Winter Season.

Comments by Planalytics, Inc. to: Investigation by the Department of Telecommunications and Energy on its own motion, pursuant to G.L.c.164 76, 94 and 94A, to investigate the appropriateness of the use of Risk-Management Techniques to Mitigate Natural Gas Price Volatility.

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**QUESTION #1**

Should Massachusetts gas utilities be allowed or required to implement a risk-management program to mitigate price volatility for gas customers?

**COMMENT #1**

**The Massachusetts gas utilities (LDC's) should be encouraged to implement a risk management program that incorporates different risk techniques in order to minimize price volatility and derive a consistently low gas price.**

**QUESTION #2**

How will risk-management by LDCs affect gas unbundling and customer choice in Massachusetts?

**COMMENT #2**

**Overall, LDC risk-management programs will result in stable, consistent pricing; thus the consumer will benefit from both reduced volatility and low prices. In an environment of low volatility and stable prices, gas unbundling and consumer choice programs become less attractive to the consumer.**

**QUESTION #3**

Should gas utilities be limited to specific types of risk-management instruments? If so, what types?

**COMMENT #3**

**The LDCs should not be limited to the risk management instruments that they use; however, the Commission should have some prior knowledge (understanding) of these instruments and their benefits. Only instruments that are designed for hedging to minimize risk should be allowed. Instruments that are based on speculation should be avoided, or at the very least, closely monitored.**

**QUESTION #4**

Should there be a percentage volume of gas that LDCs would be allowed to hedge?

**COMMENT #4**

**There is no industry standard regarding the amount of gas that should be hedged. As the “experts”, LDCs need to determine what percentage of their overall portfolio should be hedged and what instruments they plan to use.**

**QUESTION #5**

What should the core objectives of a hedging program be (e.g., least cost, price stability)?

**COMMENT #5**

**The core objective of a LDC hedging program should be to minimize price volatility. Any method of focusing purely on least cost is considered speculation. LDCs should be encouraged to spread their volume out into multiple “baskets” (different instruments) to minimize price volatility.**

**QUESTION #6**

How will the Department assess risk-management programs? What benchmarks should be used to measure a risk-management program’s performance?

**COMMENT #6**

**A commonly referenced benchmark is the NYMEX Index, which is based on the Henry Hub physical market. If a utility has generated a price that is consistently less than the NYMEX monthly settlement price then their risk-management program is working well.**

**QUESTION #7**

What standard of review should the Department apply to the utilities' initial risk-management program?

**COMMENT #7**

**Annual reviews. Quarterly reporting by the LDC is important for the Department to monitor each utilities risk-management programs, but the program that is in place must be allowed to mature so that the full benefit of each action taken be realized. In some cases it will take twelve months for a position to reach its full potential.**

**QUESTION #8**

What types of costs are associated with risk-management? Should LDCs be allowed to recover these costs? If so, please explain how.

**COMMENT #8**

**There are numerous types of costs associated with risk-management programs. The only costs that should be considered for recovery by the LDC are those that "pass the test of prudence" and those that are directly tied into financial results of the risk management program. For instance, a risk-management service could tell the LDC that conditions are bullish and lock in a certain percentage supply or bearish and tell them not to buy anything. Unless that service gives actual price ranges and volumes to buy or allocate to be bought at**

**index, and has a way to measure their results on an annual basis, then the cost should not be recoverable.**

**QUESTION #9**

Should an incentive mechanism be used in conjunction with a risk-management program? If so, please explain how this mechanism should be structured?

**COMMENT #9**

**We feel strongly that good risk-management programs contain a diversified portfolio of many types of purchases. An incentive mechanism is one way to give the utility a compelling reason to use their best efforts to save the ratepayer money. This mechanism should be part of the overall natural gas program, but not the whole program.**

**One type of incentive mechanism is a Shared Savings program where the LDC retains a portion of the savings or losses. The percentage of the savings or losses that the LDC retains can be graduated with a cap or can be a fixed percentage. There is typically a dead-band above and below the specified monthly target where savings or losses are not realized until they exceed the dead-band. Each LDC and the Department needs to work together to design an acceptable mechanism that both rewards the LDC and benefits the ratepayer.**